1402(a)(1)–(17)) from Business X, and $70,000 in income (after application of the exclusions under section 1402(a)(1)–(17)) from B's distributive share from the partnership from carrying on Business Y. Thus, B's net earnings from self-employment in Year 1 are $20,000. For Year 1, all of B's income, deductions, gains, and losses from Business X and distributive share from the partnership carrying on Business Y, other than those amounts excluded due to application of section 1402(a)(1)–(17), are taken into account in determining B's net earnings from self-employment and self-employment income for such taxable year. Accordingly, in calculating B's net investment income (as defined in §1.1411–4) for Year 1, B will not take into account the items of income, loss, gain, and deduction that comprise B's $50,000 loss attributable to Business X (after application of the exclusions under section 1402(a)(1)–(17)), and the items of income, loss, gain, and deduction that comprise B's $70,000 distributable share attributable to B's general partnership interest (after application of the exclusions under section 1402(a)(1)–(17)). Rather, only items of income, loss, gain, and deduction from the two separate businesses that were excluded from the calculation of B's net earnings from self-employment income due to the application of the exclusions under section 1402(a)(1)–(17), such as any capital gains and losses excluded under section 1402(a)(3), are considered for purposes of calculating B's net investment income for Year 1 in connection with these two trades or businesses.

Example 3. Special rule for trader with single trade or business. D is an individual engaged in the trade or business of trading in commodities (as described in §1.1411–5(a)(2)). D made a valid and timely election under section 475(f)(2). D derives $400,000 of trading gains, which are gross income described in §1.1411–4(a)(1) and $15,000 of expenses described in §1.1411–4(f)(2)(ii) from carrying on the trade or business. Pursuant to sections 475(f)(1)(D) and 1402(a)(3)(A), none of the gross income is taken into account in determining D's net earnings from self-employment and self-employment income. Therefore, under paragraph (a) of this section, the $400,000 of gross income is not covered by the exception in section 1411(c)(6). Because D had $0 net earnings from self-employment, the $15,000 of deductions did not reduce D's net earnings from self-employment under paragraph (b) of this section and §1.1411–(4)(f)(2)(ii). Therefore, the $15,000 of deductions may reduce D's gross income of $400,000 for purposes of section 1411.

Example 4. Special rule for trader with multiple trades or businesses. E is an individual engaged in two trades or businesses, Business X (which is not a trade or business of trading in financial instruments or commodities) and Business Y (which is a trade or business of trading in financial instruments or commodities (as described in §1.1411–5(a)(2)). E made a valid and timely election under section 475(f) with respect to Business Y. During Year 1, E had net earnings from self-employment from Business X of $35,000. During Year 1, E also had $300,000 of trading gains, which are gross income described in §1.1411–4(a)(1) and $40,000 of expenses described in §1.1411–4(f)(2)(ii) from Business Y. E's $300,000 of gross income from Business Y is excluded from net earnings from self-employment and self-employment income pursuant to sections 475(f)(1)(D) and 1402(a)(3)(A). E's $40,000 of deductions from Business Y reduce E's $35,000 of net earnings from self-employment from Business X to $0. Pursuant to paragraph (b) of this section and §1.1411–4(f)(2)(ii), the remaining $5,000 of deductions from Business Y are taken into account in determining E's net investment income (by reducing E's gross income of $300,000 from Business Y to $295,000) for purposes of section 1411.

(d) *Effective/applicability date.* This section applies to taxable years beginning after December 31, 2013. However, taxpayers may apply this section to taxable years beginning after December 31, 2012, in accordance with §1.1411–1(f).

[T.D. 9644, 78 FR 72424, Dec. 2, 2013]

§ 1.1411–10 Controlled foreign corporations and passive foreign investment companies.

(a) *In general.* This section provides rules that apply to an individual, estate, or trust that is a United States shareholder of a controlled foreign corporation (CFC), or that is a United States person that directly or indirectly owns an interest in a passive foreign investment company (PFIC). In addition, this section provides rules that apply to an individual, estate, or trust that owns an interest in a domestic partnership or an S corporation that is either a United States shareholder of a CFC or that has made an election under section 1295 to treat a PFIC as a qualified electing fund (QEF). References in this section to an election under paragraph (g) of this section being in effect relate to an election that is applicable to the person that is determining the section 1411 consequences with respect to holding a particular CFC or QEF.

(b) *Amounts derived from a trade or business described in §1.1411–5*—(1) *In* *general.* Except as provided in paragraph (b)(2) of this section, an amount included in gross income under section 951(a) or section 1293(a) that is also income derived from a trade or business described in section 1411(c)(2) and § 1.1411–5 (applying the relevant rules in § 1.1411–4(b)) is taken into account as net investment income under section 1411(c)(1)(A)(ii) and § 1.1411–4(a)(1)(ii) for purposes of section 1411 and the regulations thereunder when it is taken into account for purposes of chapter 1, and the rules in paragraphs (c) through (g) of this section do not apply to that amount. For purposes of section 1411 and the regulations thereunder, an amount included in gross income under section 1296(a) that is also income derived from a trade or business described in section 1411(c)(2) and § 1.1411–5 (applying the relevant rules in § 1.1411–4(b)), is net investment income within the meaning of section 1411(c)(1)(A)(ii) and § 1.1411–4(a)(1)(ii), and the rules in paragraph (c)(2)(ii) of this section do not apply to that amount.

(2) *Coordination rule for changes in trade or business status.* With respect to stock of a CFC or QEF for which an election under paragraph (g) of this section is not in effect, the rules in paragraphs (c) through (f) of this section apply to a distribution of earnings and profits described in paragraph (c)(1)(i)(A) of this section that was not taken into account as net investment income under paragraph (b) of this section.

(c) *Calculation of net investment income*—(1) *Dividends.* For purposes of section 1411(c)(1)(A)(i) and § 1.1411–4(a)(1)(i), net investment income is calculated by taking into account the amount of dividends described in this paragraph (c)(1).

(i) *Distributions of previously taxed earnings and profits*—(A) *Rules when an election under paragraph (g) of this section is not in effect with respect to the shareholder*—(*1*) *General rule.* Except as otherwise provided in this paragraph (c)(1)(i), with respect to stock of a CFC or QEF for which an election under paragraph (g) of this section is not in effect, a distribution of earnings and profits that is not treated as a dividend for chapter 1 purposes under section 959(d) or section 1293(c) is a dividend for purposes of section 1411(c)(1)(A)(i) and § 1.1411–4(a)(1)(i) if the distribution is attributable to amounts that are or have been included in gross income for chapter 1 purposes under section 951(a) or section 1293(a) in a taxable year beginning after December 31, 2012. Solely, for this purpose, distributions of earnings and profits attributable to amounts that are or have been included in gross income for chapter 1 purposes under section 951(a) or section 1293(a) are considered first attributable to those earnings and profits, if any, derived from the current taxable year, and then from prior taxable years beginning with the most recent prior taxable year, and with respect to amounts included under section 951(a), without regard to whether the earnings and profits are described in section 959(c)(1) or section 959(c)(2).

(*2*) *Exception for distributions attributable to earnings and profits previously taken into account for purposes of section 1411.* A distribution of earnings and profits that is not treated as a dividend for chapter 1 purposes under section 959(d) or section 1293(c) is not treated as a dividend for purposes of section 1411(c)(1)(A)(i) and § 1.1411–4(a)(1)(i), to the extent that an individual, estate, or trust establishes, by providing information that is similar to, and in the same manner as, the information described in § 1.959–1(d) (relating to previously taxed earnings and profits), that the distribution is attributable to—

(*i*) Amounts included in gross income by any person for chapter 1 purposes under section 951(a) or section 1293(a) that have been taken into account by any person as net investment income by reason of paragraph (b) of this section or an election under paragraph (g) of this section; or

(*ii*) Amounts included in gross income by any person as a dividend pursuant to section 1248(a) that, by reason of paragraph (c)(3)(ii) of this section, have been taken into account by any person as net investment income under section 1411(c)(1)(A)(i) and § 1.1411–4(a)(1)(i).

(B) *Rule when an election under paragraph (g) of this section is in effect with* *respect to the shareholder*. Except as otherwise provided in this paragraph (c)(1)(i), if an election under paragraph (g) of this section is in effect, a distribution of earnings and profits that is not treated as a dividend for chapter 1 purposes under section 959(d) or section 1293(c) is not treated as a dividend for purposes of section 1411(c)(1)(A)(i) and § 1.1411–4(a)(1)(i).

(C) *Special rule for certain distributions related to 2013 taxable years*—(*1*) *Scope*. The rule in this paragraph (c)(1)(i)(C) applies to individuals, estates, and trusts that were subject to section 1411 during a taxable year that began after December 31, 2012, and before January 1, 2014, and that satisfy all of the conditions set forth in paragraph (c)(1)(i)(C)(*2*) of this section. This rule also applies to all domestic partnerships and S corporations that satisfy all of the conditions set forth in paragraph (c)(1)(i)(C)(*2*) of this section.

(*2*) *Rule*. A distribution of earnings and profits from a CFC or QEF, with respect to which an election under paragraph (g) is in effect, that is not treated as a dividend for chapter 1 purposes under section 959(d) or section 1293(c) is a dividend for purposes of section 1411(c)(1)(A)(i) and § 1.1411–4(a)(1)(i) to the extent that—

(*i*) The distribution of earnings and profits is attributable to an amount included by an individual, estate, trust, domestic partnership, S corporation or common trust fund in gross income for chapter 1 purposes under section 951(a) or section 1293(a) with respect to the CFC or QEF for a taxable year that began after December 31, 2012, and before January 1, 2014;

(*ii*) The individual, estate, trust, domestic partnership, S corporation, or common trust fund made the election under paragraph (g) of this section with respect to the CFC or QEF in a taxable year that began after December 31, 2013; and

(*iii*) The individual, estate, trust, domestic partnership, S corporation, or common trust fund did not make the election described in paragraph (g)(4)(iii) of this section (concerning making an election under paragraph (g) of this section for a taxable year that begins before January 1, 2014).

(*3*) *Ordering rule*. Solely, for purposes of this paragraph (c)(1)(i)(C)(*3*), distributions of earnings and profits attributable to amounts that have been included in gross income for chapter 1 purposes under section 951(a) or section 1293(a) are considered first attributable to the earnings and profits derived from a taxable year that began after December 31, 2012, and before January 1, 2014.

(ii) *Excess distributions that constitute dividends*. To the extent an excess distribution within the meaning of section 1291(b) constitutes a dividend within the meaning of section 316(a), the amount is included in net investment income for purposes of section 1411(c)(1)(A)(i) and § 1.1411–4(a)(1)(i).

(2) *Net gain*. For purposes of section 1411(c)(1)(A)(iii) and § 1.1411–4(a)(1)(iii), the rules in this paragraph (c)(2) apply in determining net gain attributable to the disposition of property.

(i) *Gains treated as excess distributions*. Gains treated as excess distributions under section 1291(a)(2) are included in determining net gain attributable to the disposition of property for purposes of section 1411(c)(1)(A)(iii) and § 1.1411–4(a)(1)(iii).

(ii) *Inclusions and deductions with respect to section 1296 mark to market elections*. Amounts included in gross income under section 1296(a)(1) and amounts allowed as a deduction under section 1296(a)(2) are taken into account in determining net gain attributable to the disposition of property for purposes of section 1411(c)(1)(A)(iii) and § 1.1411–4(a)(1)(iii).

(iii) *Gain or loss attributable to the disposition of stock of CFCs and QEFs*. With respect to stock of a CFC or QEF for which an election under paragraph (g) of this section is not in effect, for purposes of calculating the net gain under §§ 1.1411–4(a)(1)(iii) and 1.1411–4(d) that is attributable to the direct or indirect disposition of that stock (including for purposes of determining gain or loss on the direct or indirect disposition of that stock by a domestic partnership, S corporation, or common trust fund), basis is determined in accordance with the provisions of paragraph (d) of this section.

(iv) *Gain or loss attributable to the disposition of interests in domestic partnerships or S corporations that own directly or indirectly stock of CFCs or QEFs.* With respect to stock of a CFC or QEF for which an election under paragraph (g) of this section is not in effect, for purposes of calculating the net gain under §§1.1411–4(a)(1)(iii) and 1.1411–4(d) that is attributable to the disposition of an interest in a domestic partnership or S corporation that directly or indirectly owns that stock, basis is determined in accordance with the provisions of paragraph (d) of this section.

(3) *Application of section 1248.* With respect to stock of a CFC or QEF for which an election under paragraph (g) of this section is not in effect, for purposes of section 1411 and §1.1411–4—

(i) In determining the gain recognized on the sale or exchange of stock of a foreign corporation for section 1248(a) purposes, basis is determined in accordance with the provisions of paragraph (d) of this section; and

(ii) Section 1248(a) applies without regard to the exclusion for certain earnings and profits under sections 1248(d)(1) and (d)(6), except that those exclusions will apply with respect to the earnings and profits of a foreign corporation that are attributable to:

(A) Amounts taken into account as net investment income under paragraph (b) of this section; and

(B) Amounts previously included in gross income for chapter 1 purposes under section 951(a) or section 1293(a) in a taxable year beginning before December 31, 2012, and that have not yet been distributed. For this purpose, the determination of whether earnings and profits that are attributable to amounts previously taxed in a taxable year beginning before December 31, 2012, have been distributed is determined based on the rules described in paragraph (c)(1)(i) of this section.

(4) *Amounts distributed by an estate or trust.* Net investment income of a beneficiary of an estate or trust includes the beneficiary's share of distributable net income, as described in sections 652 and 662 and as modified by paragraph (f) of this section, to the extent that the beneficiary's share of distributable net income includes items that, if they had been received directly by the beneficiary, would have been described in this paragraph (c).

(5) *Properly allocable deductions*—(i) *General rule.* For purposes of section 1411(c)(1)(B) and §1.1411–4(f), the section 163(d)(1) investment expense deduction may be calculated by—

(A) Increasing the amount of investment income determined for chapter 1 purposes under section 163(d)(4)(B) by the amount of dividends described in §1.1411–10(c) that are derived from a CFC or QEF with respect to which an election under paragraph (g) of this section is not in effect;

(B) Decreasing the amount of investment income determined for chapter 1 purposes under section 163(d)(4)(B) by the amount included in gross income for chapter 1 purposes under section 951(a) or section 1293(a) that is attributable to a CFC or QEF with respect to which an election under paragraph (g) of this section is not in effect; and

(C) Increasing or decreasing, as applicable, the amount of investment income for chapter 1 purposes under section 163(d)(4)(B) by the difference between the amount calculated with respect to a disposition under paragraphs (c)(2)(iii) and (c)(2)(iv) of this section and the amount of the gain or loss attributable to the relevant disposition as calculated for chapter 1 purposes.

(ii) *Additional rules.* For purposes of section 1411(c)(1)(B) and §1.1411–4(f), if the method of calculation described in paragraph (c)(5)(i) of this section is applied:

(A) The amount of investment interest not allowed as a deduction under section 163(d)(2) must be calculated consistent with the method of calculation described in paragraph (c)(5)(i).

(B) The method of calculation must be adopted by an individual, estate, or trust no later than the first year in which the individual, estate, or trust is subject to section 1411.

(C) The method of calculation must be applied with respect to all CFCs and QEFs for all taxable years with respect to which an election under paragraph (g) of this section is not in effect.

(D) A method of calculation under this paragraph is a method of accounting, which must be applied consistently, and may only be changed by the taxpayer by securing the consent of the

Commissioner in accordance with §1.446–1(e) and following the administrative procedures issued under §1.446–1(e)(3)(ii).

(d) *Conforming basis adjustments*—(1) *Basis adjustments under sections 961 and 1293*—(i) *Stock held by individuals, estates, or trusts.* With respect to stock of a CFC or QEF which is held by an individual, estate, or trust, either directly or indirectly through one or more entities each of which is foreign, for which an election under paragraph (g) of this section is not in effect—

(A) The basis increases made pursuant to sections 961(a) and 1293(d) for amounts included in gross income for chapter 1 purposes under sections 951(a) and 1293(a) in taxable years beginning after December 31, 2012, are not taken into account for purposes of section 1411 and the regulations thereunder; and

(B) The basis decreases made pursuant to sections 961(b) and 1293(d) attributable to amounts treated as dividends for purposes of section 1411 under paragraph (c)(1)(i) of this section are not taken into account for purposes of section 1411 and the regulations thereunder.

(ii) *Stock held by domestic partnerships or S corporations*—(A) *Rule when an election under paragraph (g) of this section is not in effect.* The rules of this paragraph (d)(1)(ii)(A) apply with respect to stock of a CFC or QEF held directly by a domestic partnership or S corporation, or indirectly through one or more entities each of which is foreign, for which an election under paragraph (g) of this section is not in effect. If an individual, estate, or trust is a shareholder of an S corporation, or if an individual, estate, or trust directly, or through one or more tiers of passthrough entities (including an S corporation), owns an interest in a domestic partnership, the S corporation or domestic partnership, as the case may be, will not take into account for purposes of section 1411 and the regulations thereunder the basis increases made by the domestic partnership or S corporation pursuant to sections 961(a) and 1293(d) for amounts included in gross income for chapter 1 purposes under sections 951(a) and 1293(a) for taxable years beginning after December 31, 2012, and the basis decreases made by the domestic partnership or S corporation pursuant to sections 961(b) and 1293(d) attributable to amounts treated as dividends for purposes of section 1411 under paragraph (c)(1)(i) of this section (the section 1411 recalculated basis). If the domestic partnership or S corporation disposes of the stock of a CFC or QEF, the section 1411 recalculated basis will be used to determine the distributive share or pro rata share of the gain or loss for purposes of section 1411 for partners or shareholders.

(B) *Rules when an election under paragraph (g) of this section is in effect.* If an election under paragraph (g) of this section is in effect with respect to stock of a CFC or QEF held directly or indirectly by a domestic partnership or S corporation, the partner's distributive share or the shareholder's pro rata share of the gain or loss for purposes of section 1411 is the same as the distributive share or pro rata share of the gain or loss for purposes of chapter 1. See *Example 6* of paragraph (h) of this section.

(2) *Special rules for partners that own interests in domestic partnerships that own directly or indirectly stock of CFCs or QEFs.* The rules of this paragraph (d)(2) apply with respect to stock of a CFC or QEF for which an election under paragraph (g) of this section is not in effect, and that is held by a domestic partnership, either directly or indirectly through one or more entities each of which is foreign. In such a case, the basis increases provided under section 705(a)(1)(A) to the partners for purposes of chapter 1 that are attributable to amounts that the domestic partnership includes or included in gross income under section 951(a) or section 1293(a) for a taxable year beginning after December 31, 2012, are not taken into account for purposes of section 1411. Instead, each partner's adjusted basis in the partnership interest is increased by its share of any distributions to the partnership from the CFC or QEF that are treated as dividends for purposes of section 1411 under paragraph (c)(1)(i) of this section. Similar rules apply when the stock of the CFC or QEF is held in a tiered partnership structure. For purposes of determining net investment

income under section 1411 and the regulations thereunder, the partner's adjusted basis in the partnership interest as calculated under this paragraph (d)(2) is used to determine all tax consequences related to tax basis (for example, loss limitation rules and the characterization of partnership distributions).

(3) *Special rules for S corporation shareholders that own interests in S corporations that own directly or indirectly stock of CFCs or QEFs.* The rules of this paragraph (d)(3) apply with respect to stock of a CFC or QEF for which an election under paragraph (g) of this section is not in effect, and that is held by an S corporation, directly or indirectly through one or more entities each of which is foreign. In such case, the basis increases provided in section 1367(a)(1)(A) to its shareholders for chapter 1 purposes that are attributable to amounts that the S corporation includes or included in gross income for chapter 1 purposes under section 951(a) or section 1293(a) for taxable years beginning after December 31, 2012, are not taken into account for purposes of section 1411. Instead, each shareholder's adjusted basis of stock in the S corporation is increased by its share of the distributions to the S corporation from the CFC or QEF that are treated as dividends for purposes of section 1411 under paragraph (c)(1)(i) of this section. Similar rules apply when the S corporation holds an interest in a CFC or QEF through a partnership. For purposes of determining net investment income under section 1411 and the regulations thereunder, the shareholder's adjusted basis in the stock of the S corporation as calculated under this paragraph (d)(3) is used to determine all tax consequences related to tax basis (for example, loss limitation rules and the characterization of S corporation distributions).

(4) *Special rules for participants in common trust funds.* Rules similar to the rules in paragraphs (d)(2) and (3) of this section apply to ownership interests in common trust funds (as defined in section 584).

(e) *Conforming adjustments to modified adjusted gross income and adjusted gross income*—(1) *Individuals.* Solely for purposes of section 1411(a)(1)(B)(i) and the regulations thereunder, the term *modified adjusted gross income* means modified adjusted gross income as defined in §1.1411–2(c)(1)—

(i) Increased by amounts included in net investment income under paragraphs (c)(1)(i), (c)(1)(ii), (c)(2)(i), and (c)(4) of this section that are not otherwise included in gross income for chapter 1 purposes;

(ii) Increased or decreased, as applicable, by the difference between the amount calculated with respect to a disposition under paragraphs (c)(2)(iii) and (iv) of this section and the amount of the gain or loss attributable to the relevant disposition as calculated for chapter 1 purposes;

(iii) Decreased by any amount included in gross income for chapter 1 purposes under section 951(a) or section 1293(a) attributable to a CFC or QEF with respect to which no election under paragraph (g) of this section is in effect; and

(iv) To the extent the section 163(d)(1) investment interest expense deduction is calculated using the method of calculation set forth in paragraph (c)(5) of this section and the deduction is taken into account under §1.1411–4(f)(2), increased or decreased, as appropriate, by the difference between the amount of the section 163(d)(1) investment interest expense deduction calculated under paragraph (c)(5) of this section and the amount calculated for chapter 1 purposes.

(2) *Estates and trusts.* Solely for purposes of section 1411(a)(2)(B)(i) and the regulations thereunder, the term *adjusted gross income* means adjusted gross income as defined in §1.1411–3(a)(1)(ii)(B)(*1*) adjusted by the following amounts to the extent those amounts are not distributed by the estate or trust—

(i) Increased by amounts included in net investment income under paragraphs (c)(1)(i), (c)(1)(ii), (c)(2)(i), and (c)(4) of this section that are not otherwise included in gross income for chapter 1 purposes;

(ii) Increased or decreased, as applicable, by the difference between the amount calculated with respect to a disposition under paragraphs (c)(2)(iii) and (iv) of this section and the amount of the gain or loss attributable to the relevant disposition as calculated for chapter 1 purposes;

(iii) Decreased by any amount included in gross income for chapter 1 purposes under section 951(a) or section 1293(a) attributable to a CFC or QEF with respect to which no election under paragraph (g) of this section is in effect; and

(iv) To the extent the section 163(d)(1) investment interest expense deduction is calculated using the method of calculation set forth in paragraph (c)(5) of this section and taken into account under § 1.1411–4(f)(2), increased or decreased, as appropriate, by the difference between the amount of the section 163(d)(1) investment interest expense deduction calculated under paragraph (c)(5) of this section and the amount calculated for chapter 1 purposes.

(f) *Application to estates and trusts.* All of the items described in paragraph (c) of this section are included in the net investment income of an estate or trust or its beneficiaries. The amounts described in paragraphs (e)(2)(i) through (iv) of this section, regardless of whether the estate or trust receives those amounts directly or indirectly through another estate or trust, increase or decrease, as applicable, the estate's or trust's distributable net income for purposes of section 1411. The estate or trust, or the beneficiaries thereof, must take those amounts into account in a manner reasonably consistent with the general operating rules for estates and trusts in § 1.1411–3 and subchapter J in computing the undistributed net investment income of the estate or trust and the net investment income of the beneficiaries.

(g) *Election with respect to CFCs and QEFs*—(1) *Effect of election.* If an election under paragraph (g) of this section is made with respect to a CFC or QEF, amounts included in gross income for chapter 1 purposes under section 951(a) or section 1293(a)(1)(A) with respect to the CFC or QEF in taxable years beginning with the taxable year for which the election is made are treated as net investment income for purposes of § 1.1411–4(a)(1)(i), and amounts included in gross income under section 1293(a)(1)(B) with respect to the QEF in taxable years beginning with the taxable year for which the election is made are taken into account in calculating net gain attributable to the disposition of property under § 1.1411–4(a)(1)(iii). See paragraphs (c)(1)(i)(B) and (c)(1)(i)(C) of this section for the effect of this election on certain distributions of previously taxed earnings and profits.

(2) *Years to which election applies*—(i) *In general.* An election under paragraph (g) of this section applies to the taxable year for which it is made and all subsequent taxable years, and applies to all subsequently acquired interests in the CFC or QEF. An election under paragraph (g) of this section is irrevocable.

(ii) *Termination of interest in CFC or QEF.* Complete termination of a person's interest in the CFC or QEF does not terminate the person's election under paragraph (g) of this section with respect to the CFC or QEF. Thus, if the person reacquires stock of the CFC or QEF, that stock is considered to be stock for which an election under paragraph (g) of this section has been made and is in effect.

(iii) *Termination of partnership.* If a domestic partnership that makes the election under paragraph (g) of this section is terminated pursuant to section 708(b)(1)(B), the election is binding on the new partnership.

(3) *Who may make the election.* An individual, estate, trust, domestic partnership, S corporation, or common trust fund may make an election under paragraph (g) of this section with respect to each CFC or QEF that it holds directly or indirectly through one or more entities, each of which is foreign. In addition, an individual, estate, trust, domestic partnership, S corporation, or common trust fund may make an election under paragraph (g) of this section with respect to a CFC or QEF that it holds indirectly through a domestic partnership, S corporation, estate, trust, or common trust fund if the domestic partnership, S corporation, estate, trust, or common trust fund does not make the election. The election, if made, for an estate or trust must be made by the fiduciary of that estate or trust.

(4) *Time and manner for making the election*—(i) *Individuals, estates, and*

trusts—(A) *General rule.* Except as otherwise provided in this paragraph, in order for an election under paragraph (g) of this section by an individual, estate, or trust (other than a CRT) with respect to a CFC or QEF to be effective, the election must be made no later than the first taxable year beginning after December 31, 2013, during which the individual, estate, or trust—

(*1*) Includes an amount in gross income for chapter 1 purposes under section 951(a) or section 1293(a) with respect to the CFC or QEF; and

(*2*) Is subject to tax under section 1411 or would be subject to tax under section 1411 if the election were made with respect to the stock of the CFC or QEF.

(B) *Special rule for charitable remainder trusts (CRTs).* Except as otherwise provided in this paragraph, in order for an election under paragraph (g) of this section by a CRT with respect to a CFC or QEF to be effective, the election must be made no later than the first taxable year beginning after December 31, 2013, during which the CRT includes an amount in gross income for chapter 1 purposes under section 951(a) or section 1293(a) with respect to the CFC or QEF.

(ii) *Certain domestic passthrough entities.* Except as otherwise provided in this paragraph, in order for an election under paragraph (g) of this section by a domestic partnership, S corporation, or common trust fund with respect to a CFC or a QEF to be effective, the election must be made no later than the first taxable year beginning after December 31, 2013, during which the domestic partnership S corporation, or common trust fund—

(A) Includes an amount in gross income for chapter 1 purposes under section 951(a) or section 1293(a) with respect to the CFC or QEF; and

(B) Has a direct or indirect owner that is subject to tax under section 1411 or would be subject to tax under section 1411 if the election were made.

(iii) *Taxable years that begin before January 1, 2014*—(A) *Individuals, estates, or trusts.* An individual, estate, or trust may make an election under paragraph (g) of this section for a taxable year that begins before January 1, 2014.

(B) *Certain domestic passthrough entities.* A domestic partnership, S corporation, or common trust fund may make an election under paragraph (g) of this section for a taxable year that begins before January 1, 2014, provided that all of its partners, shareholders, or participants, as the case may be, consent to the election. In the case of a partner, shareholder, or participant that is a partnership, S corporation, or common trust fund, all of the partners, shareholders, and participants also must consent to the election.

(iv) *Time for making election.* In all cases, the election under paragraph (g) of this section must be made in the manner prescribed by forms, instructions, or in other guidance on the individual's, estate's, trust's, domestic partnership's, S corporation's, or common trust fund's original or amended return for the taxable year for which the election is made. An election can be made on an amended return only if the taxable year for which the election is made, and all taxable years that are affected by the election, are not closed by the period of limitations on assessments under section 6501. An individual, estate, trust, domestic partnership, S corporation, or common trust fund may not seek an extension of time to make the election under any other provision of the law, including §301.9100 of this chapter.

(h) *Examples.* The following examples illustrate the rules of this section. In each example, unless otherwise indicated, the individuals, the foreign corporation (FC), the QEF (QEF), and the partnership (PRS) use a calendar taxable year. Further, the gross income or gain with respect to an interest in FC is not derived in a trade or business described in §1.1411–5.

Example 1. (i) *Facts.* A, a United States citizen, is the sole shareholder of FC, a controlled foreign corporation (within the meaning of section 957). A is a United States shareholder (within the meaning of section 951(b)) with respect to FC. In 2012, A includes $40,000 in gross income for chapter 1 purposes under section 951(a)(1)(A) with respect to FC. On December 31, 2012, A's basis in the stock of FC for chapter 1 purposes is $500,000, which includes an increase to basis under section 961(a) of $40,000. The amount of FC's earnings and profits that are described in section

959(c)(2) is $40,000, the amount of FC's earnings and profits that are described in section 959(c)(3) is $20,000, and FC does not have any earnings and profits that are described in section 959(c)(1). No election is made under paragraph (g) of this section. During 2013, A does not include any amounts in income under section 951(a) with respect to FC, A does not receive any distributions from FC, and there is no change in the amount of FC's earnings and profits. In 2014, A includes $10,000 in gross income for chapter 1 purposes under section 951(a)(1)(A) with respect to FC. As a result, A's basis in the stock of FC for chapter 1 purposes increases by $10,000 to $510,000 pursuant to section 961(a). During 2015, FC distributes $30,000 to A, which is not treated as a dividend for purposes of chapter 1 under section 959(d). As a result, A's basis in the stock of FC for chapter 1 purposes is decreased by $30,000 to $480,000 pursuant to section 961(b).

(ii) *Results for section 1411 purposes.* In 2014, A does not include the $10,000 section 951(a) income inclusion in A's net investment income under section 1411(c)(1)(A)(i) and §1.1411–4(a)(1)(i). Pursuant to paragraph (e)(1)(iii) of this section, A decreases A's modified adjusted gross income for section 1411 purposes by $10,000 in 2014, and pursuant to paragraph (d)(1)(i) of this section, A's adjusted basis is not increased by $10,000 and remains at $500,000. In 2015, pursuant to paragraph (c)(2)(i) of this section, A includes $10,000 of the distribution of previously taxed earnings and profits as a dividend for purposes of determining A's net investment income because $10,000 of the $30,000 distribution is attributable to amounts that A included in gross income for chapter 1 purposes under section 951(a) in a tax year that began after December 31, 2012. Pursuant to paragraph (e)(1)(i) of this section, A increases A's modified adjusted gross income for section 1411 purposes by $10,000 in 2015. Under paragraph (d)(1)(i) of this section, A's adjusted basis is not decreased by the $10,000 that is treated as a dividend for section 1411 purposes, and thus, A's adjusted basis in FC for section 1411 purposes is decreased under section 961 only by $20,000 to $480,000.

Example 2. (i) *Facts.* Same facts as *Example 1*. In addition, during 2016, A includes $15,000 in gross income for chapter 1 purposes under section 951(a)(1)(A) with respect to FC. As a result, A's basis in the stock of FC for chapter 1 purposes increases by $15,000 to $495,000 pursuant to section 961(a). During 2017, A sells all of A's shares of FC for $550,000 and, prior to the application of section 1248, recognizes $55,000 ($550,000 minus $495,000) of long-term capital gain for chapter 1 purposes. For purposes of calculating the amount included in income as a dividend pursuant to section 1248(a) for chapter 1 purposes, the earnings and profits of FC attributable to A's shares in FC which were accumulated after December 31,1962 and during the period which A held the stock while FC was a controlled foreign corporation is $55,000, $35,000 of which is excluded pursuant to section 1248(d)(1). Therefore, after the application of section 1248, for chapter 1 purposes, upon the sale of the FC stock, A recognizes $35,000 of long-term capital gain and a $20,000 dividend.

(ii) *Results for section 1411 purposes.* (A) In 2016, A does not include the $15,000 section 951(a)(1)(A) income inclusion in A's net investment income under section 1411(c)(1)(A)(i) and §1.1411–1(a)(1)(i). Pursuant to paragraph (e)(1)(ii) of this section, A decreases A's modified adjusted gross income for section 1411 purposes by $15,000, and, pursuant to paragraph (d)(1)(i) of this section, A's adjusted basis remains at $480,000.

(B) During 2017, prior to the application of section 1248, A recognizes $70,000 ($550,000 minus $480,000) of gain for section 1411 purposes. Pursuant to paragraph (c)(3) of this section, for section 1411 purposes, section 1248(a) applies to the gain on the sale of FC calculated for section 1411 purposes ($70,000) and section 1248(d)(1) does not apply, except with respect to the $20,000 of earnings and profits of FC that are attributable to amounts previously included in income for chapter 1 purposes under section 951 for a taxable year beginning before December 31, 2012. Accordingly, for purposes of calculating the amount of income includible as a dividend under section 1248(a), A has $55,000 of earnings and profits, $20,000 of which is excluded pursuant to section 1248(d)(1). Therefore, after the application of section 1248, for section 1411 purposes A has $35,000 of long-term capital gain and a $35,000 dividend. For purposes of calculating net investment income in 2017, A includes $35,000 as a dividend under section 1411(c)(1)(A)(i) and §1.1411–4(a)(1)(i) and $35,000 as a gain under section 1411(c)(1)(A)(iii) and §1.1411–4(a)(1)(iii).

Example 3. (i) *Facts.* Same facts as *Example 2*, except that A timely makes an election under paragraph (g)(4)(i) of this section for 2014 (and thus for all subsequent years).

(ii) *Results for section 1411 purposes.* A does not have any adjustments to A's modified adjusted gross income for section 1411 purposes for 2014, 2015, 2016 or 2017 because the election under paragraph (g)(4)(i) of this section was timely made. Pursuant to paragraph (g)(2) of this section, for purposes of calculating A's net investment income in 2014, the $10,000 that A included in income for chapter 1 purposes under section 951(a) is net investment income for purposes of section 1411(c)(1)(A)(i) and §1.1411–4(a)(1)(i). A has no amount of net investment income with respect to FC in 2015. Pursuant to paragraph (g)(2) of this section, for purposes of calculating A's net investment income in 2016, the $15,000 that A included in income for chapter

1 purposes under section 951(a) is net investment income for purposes of section 1411(c)(1)(A)(i) and §1.1411–4(a)(1)(i). For purposes of calculating A's net investment income in 2017, the amount of gain on the disposition of the FC shares is the same as the amount calculated for chapter 1 purposes. Applying section 1248, A includes $35,000 as a gain under section 1411(c)(1)(A)(iii) and §1.1411–4(a)(1)(iii), and $20,000 as a dividend under section 1411(c)(1)(A)(i) and §1.1411–4(a)(1)(i).

Example 4. Domestic partnership holding QEF stock. (i) *Facts.* (A) C, a United States citizen, owns a 50% interest in PRS, a domestic partnership. D, a United States citizen, and E, a United States citizen, each own a 25% interest in PRS. All allocations of partnership income and losses are pro rata based on ownership interests. PRS owns an interest in QEF, a foreign corporation that is a passive foreign investment company (within the meaning of section 1297(a)). PRS, a United States person, made an election under section 1295 with respect to QEF applicable to the first year of its holding period in QEF. As of December 31, 2012, for chapter 1 purposes, C's basis in his partnership interest is $100,000, D's basis in his partnership interest is $50,000, E's basis in his partnership interest is $50,000, and PRS's adjusted basis in its QEF stock is $80,000, which includes an increase in basis under section 1293(d) of $40,000. As of December 31, 2012, the amount of QEF's earnings that have been included in income by PRS under section 1293(a), but have not been distributed by QEF, is $40,000. PRS also has cash of $60,000 and domestic C corporation stock with an adjusted basis of $60,000. During 2013, PRS does not include any amounts in income under section 1293(a) with respect to QEF, PRS does not receive any distributions from QEF, and there are no adjustments to the basis of C, D, or E in their interests in PRS.

(B) During 2014, PRS has income of $40,000 under section 1293(a) with respect to QEF and has no other partnership income. PRS does not make an election under paragraph (g) of this section.

(C) During 2015, QEF distributes $60,000 to PRS. PRS has no income for the year.

(ii) *Results for 2014.* (A) For chapter 1 purposes, as a result of the $40,000 income inclusion under section 1293(a), PRS's basis in its QEF stock is increased by $40,000 under section 1293(d)(1) to $120,000. Under §1.1293–1(c)(1) and section 702, C's, D's, and E's distributive shares of the section 1293(a) income inclusion are $20,000, $10,000, and $10,000, respectively. Under section 705(a)(1)(A), C increases his adjusted basis in his partnership interest by $20,000 to $120,000, and D and E each increase his adjusted basis in his partnership interest by $10,000 to $60,000.

(B) For section 1411 purposes, pursuant to paragraph (d)(1)(ii) of this section, PRS's basis in QEF is not increased by the $40,000 income inclusion (it remains at $80,000). Because PRS did not make an election under paragraph (g) of this section, C, D and E do not have net investment income with respect to the income inclusion, and pursuant to paragraph (d)(2) of this section, they do not increase their adjusted bases in their interests in PRS (each remains at $50,000). Pursuant to paragraph (e)(1)(ii) of this section, C reduces his modified adjusted gross income by $20,000, and D and E each reduce their modified adjusted gross income by $10,000.

(iii) *Results for 2015.* (A) For chapter 1 purposes, the distribution of $60,000 from QEF to PRS is not a dividend under section 1293(c), and PRS decreases its basis in QEF by $60,000 under section 1293(d)(2) to $60,000.

(B) Pursuant to paragraph (c)(1)(i) of this section, $40,000 of the distribution is a dividend for section 1411 purposes because PRS included $40,000 in gross income for chapter 1 purposes under section 1293(a) in a tax year that began after December 31, 2012. For section 1411 purposes, pursuant to paragraph (d)(1)(ii) of this section, section 1293(d) will not apply to reduce PRS's basis in QEF to the extent of the $40,000 of the distribution that is treated as a dividend under paragraph (c)(2)(i) of this section. Thus, PRS's basis in QEF is decreased only by $20,000 for purposes of section 1411 and is $60,000. The $40,000 distribution of previously taxed earnings and profits that is treated as a dividend for section 1411 purposes is allocated $20,000 to C, $10,000 to D, and $10,000 to E. Because PRS did not make an election under paragraph (g) of this section, pursuant to paragraph (c)(2)(i) of this section, C has $20,000 of net investment income, and D and E each has $10,000 of net investment income as a result of the distribution by QEF, and pursuant to paragraph (d)(2) of this section, C increases his adjusted basis in PRS by $20,000 to $120,000, and D and E each increases his adjusted basis in PRS by $10,000 to $60,000. Pursuant to paragraph (e)(1)(i) of this section, C increases his modified adjusted gross income by $20,000, and D and E each increases his modified adjusted gross income by $10,000.

Example 5. Sale of partnership interest. (i) *Facts.* Same facts as *Example 4.* In addition, in 2016, D sells his entire interest in PRS to F for $100,000.

(ii) *Results for 2016.* For chapter 1 purposes, D has a gain of $40,000 ($100,000 minus $60,000). For section 1411 purposes, D has a gain of $40,000 ($100,000 minus $60,000), and thus, has net investment income of $40,000. No adjustments to modified adjusted gross income are necessary under paragraph (e) of this section.

Example 6. Domestic partnership's sale of QEF stock. (i) *Facts.* Same facts as *Example 4.* In addition, in 2016 PRS has income of $60,000 under section 1293(a) with respect to QEF, and in 2017, PRS sells its entire interest in QEF for $170,000.

(ii) *Results for 2016*. (A) For chapter 1 purposes, as a result of the $60,000 income inclusion under section 1293(a), PRS's basis in its QEF stock is increased by $60,000 under section 1293(d)(1) to $120,000. Under § 1.1293–1(c)(1) and section 702, C's, D's, and E's distributive shares of the section 1293(a) income inclusion are $30,000, $15,000, and $15,000 respectively. Under section 705(a)(1)(A), C increases his adjusted basis in his partnership interest by $30,000 to $150,000, and D and E each increases his adjusted basis in his partnership interest by $15,000 to $75,000.

(B) For section 1411 purposes, pursuant to paragraph (d)(1)(ii) of this section, PRS's basis in QEF is not increased by the $60,000 income inclusion (it remains at $60,000). Because PRS did not make an election under paragraph (g) of this section, C, D and E do not have net investment income with respect to the income inclusion, and pursuant to paragraph (d)(2) of this section, they do not increase their adjusted bases in their interests in PRS (C remains at $120,000, and D and E each remain at $60,000). Pursuant to paragraph (e)(1)(ii) of this section, C reduces his modified adjusted gross income by $30,000, and D and E each reduce their modified adjusted gross income by $15,000.

(iii) *Results for 2017*. (A) For chapter 1 purposes, PRS has a gain of $50,000 ($170,000 minus $120,000), which is allocated 50% ($25,000) to C, 25% ($12,500) to D, and 25% ($12,500) to E.

(B) Based on PRS's basis in the stock of QEF for section 1411 purposes, PRS has a gain for section 1411 purposes of $110,000 ($170,000 minus $60,000), which in the absence of an election by PRS under paragraph (g) of this section, results in gain of $55,000 to C, $27,500 to D, and $27,500 to E. Therefore, C has net investment income of $55,000, and D and E each have net investment income of $27,500. Pursuant to paragraph (e)(1)(ii) of this section, C increases his modified adjusted gross income by $30,000, and D and E each increase their modified adjusted gross income by $15,000.

(i) *Effective/applicability date*. This section applies to taxable years beginning after December 31, 2013. However, taxpayers may apply this section to taxable years beginning after December 31, 2012, in accordance with § 1.1411–1(f).

[T.D. 9644, 78 FR 72424, Dec. 2, 2013, as amended at 79 FR 18160, Apr. 1, 2014]

WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS AND TAX-FREE COVENANT BONDS

NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

§ 1.1441–0 Outline of regulation provisions for section 1441.

This section lists captions contained in §§ 1.1441–1 through 1.1441–9.

§ 1.1441–1 Requirement for the deduction and withholding of tax on payments to foreign persons.

(a) Purpose and scope.

(b) General rules of withholding.

(1) Requirement to withhold on payments to foreign persons.

(2) Determination of payee and payee's status.

(i) In general.

(ii) Payments to a U.S. agent of a foreign person.

(iii) Payments to wholly-owned entities.

(A) Foreign-owned domestic entity.

(B) Foreign entity.

(iv) Payments to a U.S. branch of certain foreign banks or foreign insurance companies.

(A) U.S. branch treated as a U.S. person in certain cases.

(B) Consequences to the withholding agent.

(C) Consequences to the U.S. branch.

(D) Definition of payment to a U.S. branch.

(E) Payments to other U.S. branches.

(v) Payments to a foreign intermediary.

(A) Payments treated as made to persons for whom the intermediary collects the payment.

(B) Payments treated as made to foreign intermediary.

(vi) Other payees.

(vii) Rules for reliably associating a payment with a withholding certificate or other appropriate documentation.

(A) Generally.

(B) Special rules applicable to a withholding certificate from a nonqualified intermediary or flow-through entity.

(C) Special rules applicable to a withholding certificate provided by a qualified intermediary that does not assume primary withholding responsibility.

(D) Special rules applicable to a withholding certificate provided by a qualified intermediary that assumes primary withholding responsibility under chapter 3 of the Internal Revenue Code.

(E) Special rules applicable to a withholding certificate provided by a qualified intermediary that assumes primary Form 1099 reporting and backup withholding responsibility but not primary withholding under chapter 3.